Nevertheless, AT&T fails to identify any additional costs that Verizon will be able to avoid in the future. Instead, AT&T simply claims that the starting point for an avoided cost study should be the assumption of a fully competitive market. This is not supported by section 252(d)(3) or by the Eighth Circuit's decision.[1734] Although assumptions about the existence of a competitive market are relevant to UNE pricing under section 252(d)(1) and the Commission's rules implementing that section, nothing in section 252(d)(3) calls for such assumptions in determining the wholesale discount. Notably, section 252(d)(1) specifically requires the determination of UNE rates "without reference to a rate-based proceeding," whereas section 251(d)(3) requires the determination of the wholesale discount "on the basis of retail rates charged to subscribers."[1735] Moreover, even were we to accept AT&T's assumption, AT&T fails to present any evidence showing the costs that Verizon would avoid if operating in such a market place. Indeed, AT&T fails to identify with specificity any cost that Verizon will avoid in the future beyond those Verizon avoids today.[1736] Consequently, based on the record before us, we will establish wholesale discount rates based on those costs that a party shows Verizon actually avoids in providing services to resellers.

C. Vertical Features / Stand-Alone Services

1. Positions of the Parties

675. Verizon claims that the wholesale discount should not apply to vertical features as stand-alone services because it does not offer vertical features at retail on a stand-alone basis.[1737] Alternatively, Verizon argues that, if it is required to offer vertical features subject to the wholesale discount, a different discount rate should apply because Verizon would avoid different costs if it were providing only vertical services at wholesale to AT&T, while continuing to provide dial tone to the retail end-user.[1738] For example, Verizon would not avoid billing functions because it would continue to send a bill to the end-user.[1739] Verizon did not propose separate discount rates for vertical features offered as stand-alone services.[1740]

[1734] *See* 47 U.S.C. § 252(d)(3); *Iowa Utilities II*, 219 F.3d at 755-56.

[1735] *Compare* 47 U.S.C. § 252(d)(1), *with* 47 U.S.C. § 252(d)(3). Indeed, in comparing the UNE pricing standard to retail rate setting, the Supreme Court found that the UNE pricing standard "appears to be an explicit disavowal of the public-utility model of rate regulation . . . for retail sales . . . in favor of novel ratesetting." *Verizon v. FCC*, 535 U.S. at 489.

[1736] Specific disagreements between the parties regarding the costs that should be considered avoided today are discussed *infra* in section XII(D).

[1737] *See* Verizon Ex. 121, at 11-13; Tr. at 3714.

[1738] Tr. at 3714; *see also* Verizon Ex. 121, at 12; Verizon Reply Cost Brief at 193.

[1739] Tr. at 3715; *see also* Verizon Ex. 121, at 12; Verizon Reply Cost Brief at 193-94.

[1740] Tr. at 3714-16; *see also* AT&T/WorldCom Initial Cost Brief at 238.

676. AT&T argues that it should be able to purchase vertical services, and other services, on a stand-alone basis, even if Verizon does not offer them at retail to end-users.[1741] AT&T reasons that it should not be required to purchase a service that it does not want (*e.g.*, dial tone) in order to purchase a service that it does want (*e.g.*, vertical features).[1742] AT&T further argues that the same wholesale discount should apply to vertical features that applies to any other service.[1743] AT&T explains that, although Verizon would avoid substantially fewer costs with respect to the end-user to which it continues to provide dial tone, Verizon would also recover its full retail costs from that end-user.[1744] Thus, in that scenario, the costs of providing dial tone to the Verizon retail customer would be irrelevant to the analysis.[1745] Rather, the avoided costs would be those avoided when examining only the vertical service.[1746] Therefore, the same wholesale discount should apply.[1747]

2. Discussion

677. We decline to establish wholesale discount rates for vertical features or other stand-alone services. In the *Non-Cost Arbitration Order*, we found that Verizon is not obligated to offer for resale more discrete services than it offers to its retail customers.[1748] Further, AT&T fails to challenge Verizon's statements that Verizon does not offer vertical features on a stand-alone basis. Therefore, we found that it was not necessary to calculate a separate wholesale discount for vertical features.[1749] AT&T offers no additional reasons here for us to depart from our conclusion in the *Non-Cost Arbitration Order*. We, therefore, reiterate that Verizon does not, nor is it required to, offer vertical services on a stand-alone basis for resale. Accordingly, we do not require separate wholesale discounts for vertical features or other stand-alone services.

[1741] *See* AT&T Ex. 14, at 12-13.

[1742] *See id.*

[1743] *See id.*; AT&T/WorldCom Initial Cost Brief at 237-38.

[1744] *See* AT&T Ex. 14, at 12-13; AT&T/WorldCom Initial Cost Brief at 238.

[1745] *See* AT&T Ex. 14, at 12-13; AT&T/WorldCom Initial Cost Brief at 238.

[1746] *See* AT&T Ex. 14, at 12-13; AT&T/WorldCom Initial Cost Brief at 238.

[1747] *See* AT&T Ex. 14, at 12-13; AT&T/WorldCom Initial Cost Brief at 238.

[1748] *Non-Cost Arbitration Order*, 17 FCC Rcd at 27351, para. 642 (citing *Local Competition First Report and Order*, 11 FCC Rcd at 15924, 15936, paras. 872, 877); 47 U.S.C. § 251(c)(4) (Verizon must offer at resale only those "telecommunications service[s] that the carrier provides at retail to subscribers who are not telecommunications carriers").

[1749] *Non-Cost Arbitration Order*, 17 FCC Rcd at 27351, para. 642.

D. Avoided Costs

1. Introduction

678. Verizon is the only party that submitted an avoided cost study. Verizon calculated wholesale discounts for two scenarios:

14.68 percent – Reseller using own operator services and directory assistance (OS/DA)[1750]

13.06 percent – Reseller using Verizon's OS/DA[1751]

679. To determine its proposed discount rates, Verizon analyzed its expenses by function codes, using information from its 1999 functional accounting data to determine the costs that it will actually avoid in providing wholesale services.[1752] In addition to excluding direct avoided costs, Verizon excluded "those indirect expenses that vary with the level of retail output."[1753] To determine the applicable discount when the reseller does not use Verizon's OS/DA, Verizon removed the expenses associated with the Call Completion/Number Services and Operator Services accounts.[1754]

680. AT&T challenge Verizon's determinations regarding which expenses will be avoided.[1755] We address these claims in the following subsections.

2. Direct Expenses

a. Product Advertising

(i) Positions of the Parties

681. AT&T claims that Product Advertising (Account 6613) should be treated as an avoided cost.[1756] AT&T alleges that, as Verizon loses market share, Verizon will decrease its

[1750] Verizon Ex. 139 (Errata to Exhibits 100 and 107); Tr. at 3710-12; *see also* Verizon Ex. 121, at 1; Verizon Reply Cost Brief at 181.

[1751] *See* Verizon Ex. 121, at 1; Verizon Reply Cost Brief at 182; Verizon Ex. 107, at 340-41; *see also* Verizon Ex. 100P, Vol. VIII, Part F-6, Tab 1 at 1 (confidential version).

[1752] Verizon Ex. 107, at 337, 339-55; *see also* Tr. at 3696-700; Verizon Initial Cost Brief at 225-26. The accounting data is contained in Verizon's books maintained according to the uniform system of accounts.

[1753] Verizon Ex. 107, at 341; *see also id.* at 345, 358-60.

[1754] *Id.* at 340.

[1755] *See* AT&T Ex. 14, at 8-12; AT&T/WorldCom Initial Cost Brief at 233, 235-37.

[1756] AT&T Ex. 14, at 9-10; *see also* AT&T/WorldCom Initial Cost Brief at 233, 235-37.

advertising budget.[1757] AT&T also contends that, because competitive LECs must pay for their own advertising, they should not also have to pay for Verizon's advertising by including these costs in wholesale rates.[1758]

682. Verizon claims that Product Advertising is not an avoided cost.[1759] Instead, Verizon contends that it would likely increase rather than decrease its advertising expenses if it lost considerable market share.[1760] Indeed, Verizon asserts that AT&T's advertising expenses increased after divestiture while AT&T lost market share in the long distance market place.[1761] Verizon also claims that its advertising would generally lead to greater total market penetration for all telecommunications services purchased by end-users, including some services that would be purchased from resellers, such as AT&T, rather than from Verizon.[1762] AT&T and other resellers, therefore, would benefit from Verizon's advertising expenses.[1763]

683. AT&T rebuts Verizon's claims regarding AT&T's post-divestiture advertising expenses, asserting that, following divestiture, AT&T's advertising expenses reflected a generally consistent percentage of revenues.[1764] AT&T also contends that it will not gain resale end-user customers as a result of Verizon's advertising.[1765]

(ii) Discussion

684. We agree with Verizon. Neither party presented convincing evidence showing that there is an expected trend in advertising expenses as market share declines. Nevertheless, we credit Verizon's claim that it would respond to losses in its local retail business to competitive LECs by increasing its advertising both to retain and to win back customers. To the extent that AT&T proposes that all advertising costs be avoided, moreover, AT&T undermined its position with its claim that its advertising costs remained constant as a percentage of revenues

[1757] AT&T Ex. 14, at 9.

[1758] *Id.* at 9-10.

[1759] Verizon Ex. 107, at 346-47; Verizon Ex. 121, at 9; Tr. at 3716-18; *see also* Verizon Initial Cost Brief at 226-27; Verizon Reply Cost Brief at 191-92.

[1760] Verizon Ex. 121, at 5-6; Tr. at 3717-18; *see also* Verizon Initial Cost Brief at 226.

[1761] Verizon Ex. 121, at 6; Tr. at 3721; *see also* Verizon Initial Cost Brief at 226.

[1762] Verizon Ex. 107, at 347; Verizon Ex. 121, at 5-6; Tr. at 3718-19; *see also* Verizon Initial Cost Brief at 227.

[1763] *See* Verizon Ex. 107, at 347; Verizon Ex. 121, at 5-6; Tr. at 3718-19; Verizon Initial Cost Brief at 227.

[1764] *See* Verizon Ex. 121, at Attach. A (AT&T/WorldCom Response to Verizon Data Request 13-10); Tr. at 3722-23.

[1765] *See* AT&T/WorldCom Initial Cost Brief at 236.

post-divestiture at the same time that its market share declined.[1766] Thus, although AT&T may have avoided some of its advertising costs as competition increased, it certainly did not avoid all of its costs. AT&T did not offer evidence that Verizon might avoid only a percentage of its advertising expenses. Between the proposals before us, therefore, we find for Verizon and do not require Verizon to treat its product advertising expenses as avoided.

b. Call Completion and Number Services

(i) Positions of the Parties

685. AT&T claims that Verizon errs by not treating as avoided any of the costs associated with Call Completion (Account 6621) and Number Services (Account 6622).[1767] AT&T claims that these costs will be avoided if a competitive LEC is providing its own operator services and directory assistance.[1768]

686. Verizon offers two different wholesale discount rates, one where the competitive LEC uses Verizon's OS/DA and one where the competitive LEC does not use Verizon's OS/DA.[1769] In calculating the wholesale discount when the competitive LEC does not use Verizon's OS/DA, Verizon excluded both the retail revenues from these services and the expenses associated with providing these services in determining the discount rate.[1770]

(ii) Discussion

687. We agree with Verizon on this issue. Call Completion and Number Services expenses should be excluded from the discount rate calculations when a competitive LEC does not use Verizon's OS/DA, but should included when a competitive LEC uses Verizon's OS/DA. Verizon properly excludes both revenues and expenses associated with its OS/DA when calculating the wholesale discount for competitive LECs that use their own OS/DA.[1771] Similarly, Verizon properly includes both revenues and expenses associated with its OS/DA when calculating the wholesale discount for competitive LECs that use Verizon's OS/DA.[1772]

[1766] *See* Verizon Ex. 121, at Attach. A; Tr. at 3722-23.

[1767] AT&T Ex. 14, at 10.

[1768] *Id.*

[1769] Verizon Ex. 107, at 340, 357-58; Verizon Ex. 121, at 7-8.

[1770] Verizon Ex. 121, at 7-8; *see also* Verizon Initial Cost Brief at 227.

[1771] *See* Verizon Ex. 121, at 7-8.

[1772] *See id.*

3. Indirect Expenses

a. Information Management

(i) Positions of the Parties

688. AT&T claims that Information Management (Account 6724) includes costs that will be avoided just as General Purpose Computers (Account 6124) does.[1773] Verizon's avoided cost study identifies 45.38 percent of costs in the General Purpose Computers account as avoided.[1774] AT&T contends that, if the computer expenses are avoided, then the associated indirect information system programming and maintenance expenses that are in the Information Management would also be avoided.[1775]

689. Verizon explains that AT&T confuses the expenses included in the General Purpose Computer and the Information Management accounts.[1776] The General Purpose Computers account expenses are mainly those associated with physical computer hardware.[1777] When Verizon treats the work of a specific functional group (*e.g.*, product management) as avoided, then the computer hardware expenses associated with that group are similarly avoided.[1778] Information Management expenses are distinct from the expenses included in the General Purpose Computers account.[1779] Specifically, Information Management expenses relate to the databases and software applications used in Verizon's data centers.[1780] Unlike General Purpose Computers expenses, there is no correlation between Information Management expenses and the work groups whose expenses are avoided (*e.g.*, product management).[1781] Verizon provides the following example to explain AT&T's error:

> [A] program that is run to update Verizon VA plant in-service records pursuant to recent service orders – which would be charged to the Information Management account – is not avoided simply because an end-user takes service from a reseller

---

[1773] AT&T Ex. 14, at 11-12.

[1774] *See id.* at 11.

[1775] *Id.* at 11-12.

[1776] Verizon Ex. 121, at 9-10; *see also* Verizon Initial Cost Brief at 227-28 n.267.

[1777] Verizon Ex. 121, at 9.

[1778] *Id.*

[1779] *Id.* at 10.

[1780] *Id.*

[1781] *Id.*

rather than Verizon VA retail.[1782]

(ii) Discussion

690. We agree with Verizon because, as Verizon explains, the expenses identified in the two accounts do not have the same correlation to accounts that contain expenses for avoided costs. We decline, therefore, based on the record before us, to require Verizon to exclude costs from its Information Management Account when calculating the wholesale discount rates.

b. Office Equipment and Human Resources

(i) Positions of the Parties

691. AT&T claims that, just as Verizon identifies 100 percent of the expenses associated with Sales (Account 6612) as expenses that are avoided, all of the costs associated with the people who perform the sales functions – *e.g.*, their salaries, office equipment, office space, and the human resources support to hire and fire them – should be avoided. These indirect expenses are reflected in the Office Equipment and the Human Resources accounts (Accounts 6123 and 6723).[1783]

692. Verizon claims that AT&T is wrong for two reasons.[1784] First, 100 percent of sales activities are not avoided.[1785] Rather, the percentage of sales expenses that will be avoided will equal the percentage of lines that switch to resellers.[1786] Second, any decline in the amount of retail sales activity probably will not lead to a direct, linear decline in the amount of indirect avoided costs.[1787] For example, a ten percent decline in retail sales activity likely will not lead to a ten percent decline in sales office copier expenses or other indirect expenses.[1788]

(ii) Discussion

693. We agree with AT&T. Verizon's avoided cost study identifies 100 percent of the Sales account (6612) as avoided.[1789] The Verizon surrebuttal testimony thus mischaracterizes

---

[1782] *Id.*

[1783] AT&T Ex. 14, at 10-11.

[1784] Verizon Ex. 121, at 10-11.

[1785] *Id.* at 11; *see also* Verizon Initial Cost Brief at 227-28 n.267.

[1786] *See* Verizon Ex. 121, at 11.

[1787] *See id.*

[1788] *See id.*

[1789] Verizon Ex. 100, Part F-6 at 1, line 2; Verizon Ex. 107, at 346; Tr. at 3759.

Verizon's own study.[1790] We therefore require Verizon to re-run its avoided cost study, removing the appropriate percentage of expenses from accounts 6123 and 6723 that are associated with expenses in account 6612.

XIII. RATES AND COMPLIANCE FILING

694. As we explain in detail herein, in this order we establish recurring rates for all loop types presented by the parties. Appendix E contains a list of the ordered loop rates. In particular, we set basic 2-wire and 4-wire loop rates based on the MSM (as modified by this order) filed by AT&T/WorldCom. The component loop output costs from the MSM are attached to this order at Appendix F, and the input files containing all of the modifications we are making to the AT&T/WorldCom submission are attached at Appendix G.[1791]

695. To establish recurring rates for all other UNEs (*i.e.*, non-loops), we adopt Verizon's recurring cost studies, subject to the modifications that we require herein. We direct Verizon to resubmit its recurring costs studies, modifying them to reflect the changes – and only those changes – set forth herein. Along with its cost studies, we require Verizon to submit testimony, workpapers, and/or other filings that explain in detail the specific changes it makes to its studies to implement the changes required by this order. Verizon shall file its cost studies, along with any necessary supporting documentation, within 60 days from the date of release of this order. AT&T and WorldCom may file rebuttal testimony, along with any necessary supporting documentation, within 81 from the date of release of this order.

696. We adopt the AT&T/WorldCom non-recurring cost study to establish NRCs. We direct AT&T/WorldCom to resubmit the non-recurring cost study, modified to reflect the changes – and only those changes – set forth in this order, including the requirement that AT&T/WorldCom generate NRCs for additional UNEs beyond those contained in AT&T/WorldCom's submission. Along with their revised cost study, we require AT&T/WorldCom to submit testimony, workpapers, and/or other filings that explain in detail the specific changes they make to their study to implement the changes required by this order. AT&T/WorldCom shall file their cost study, along with any necessary supporting documentation, within 60 days from the date of release of this order. Verizon may file rebuttal testimony, along with any necessary supporting documentation, within 81 days from the date of release of this order.

697. We adopt the Verizon avoided cost study to establish wholesale discounts. We direct Verizon to resubmit its avoided cost study, modified to reflect the change – and only the change – set forth in this order. Along with its cost studies, we require Verizon to submit testimony, workpapers, and/or other filings that explain in detail the specific changes it makes to its study to implement the change required by this order. Verizon shall file its cost study, along

[1790] *See* Verizon Ex. 121, at 11.

[1791] All appendices attached to this order are hereby incorporated into this order by this reference.

with any necessary supporting documentation, within 60 days from the date of release of this order. AT&T and WorldCom may file rebuttal testimony, along with any necessary supporting documentation, within 81 days from the date of release of this order.

698. We direct the parties to apply the rates that we order in this proceeding, except as otherwise required by the true-up provisions discussed above, in the manner and time frame required by the terms of the parties' interconnection agreements, or in no case later than the effective date of the Bureau's forthcoming order addressing the parties' compliance filings for recurring charges for non-loop UNEs and for all NRCs. We note, however, that as part of its application for section 271 authority in Virginia, Verizon stated that it would make the switching rates established in this proceeding effective as of August 1, 2002.[1792] We expect Verizon to abide by this commitment. Except as specified above, this order is effective immediately.

XIV. ORDERING CLAUSES

699. Accordingly, IT IS ORDERED that, pursuant to Section 252 of the Communications Act of 1934, as amended, and Sections 0.91, 0.291 and 51.807 of the Commission's rules, 47 U.S.C. § 252 and 47 C.F.R. §§ 0.91, 0.291, 51.807, the issues presented for arbitration are determined as set forth in this Order, effective as specified *supra* in section XIII.

700. IT IS FURTHER ORDERED that the Verizon NRCM Motion is hereby GRANTED; the Verizon New Evidence Filing is hereby DENIED; the Verizon Motion to Re-open the Record is hereby DENIED; and the Verizon Supplemental Proffer is hereby DENIED.

701. IT IS FURTHER ORDERED that Verizon Virginia, Inc. SHALL SUBMIT a compliance filing consistent with paragraphs 695 and 697 of this Order, and that AT&T Communications of Virginia, Inc. and WorldCom, Inc. MAY SUBMIT a rebuttal filing consistent with paragraphs 695 and 697 of this Order.

702. IT IS FURTHER ORDERED that AT&T Communications of Virginia, Inc. and WorldCom, Inc. SHALL SUBMIT a compliance filing consistent with paragraph 696 of this

[1792] *Application by Verizon Virginia Inc., Verizon Long Distance Virginia, Inc., Verizon Enterprise Solutions Virginia Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia Inc., for Authorization to Provide In-Region, InterLATA Services in Virginia*, WC 02-214, Memorandum Opinion and Order, 17 FCC Rcd 21880 at 21945-46, para. 114 (2002) ("Verizon states that it has agreed to make any switching rates set during the Virginia Arbitration Proceeding effective as of August 1, 2002, the date of its Virginia section 271 application.").

Order, and that Verizon Virginia, Inc. MAY SUBMIT a rebuttal filing consistent with paragraph 696 of this Order.

By Order of the Bureau,

William F. Maher, Jr.
Chief, Wireline Competition Bureau